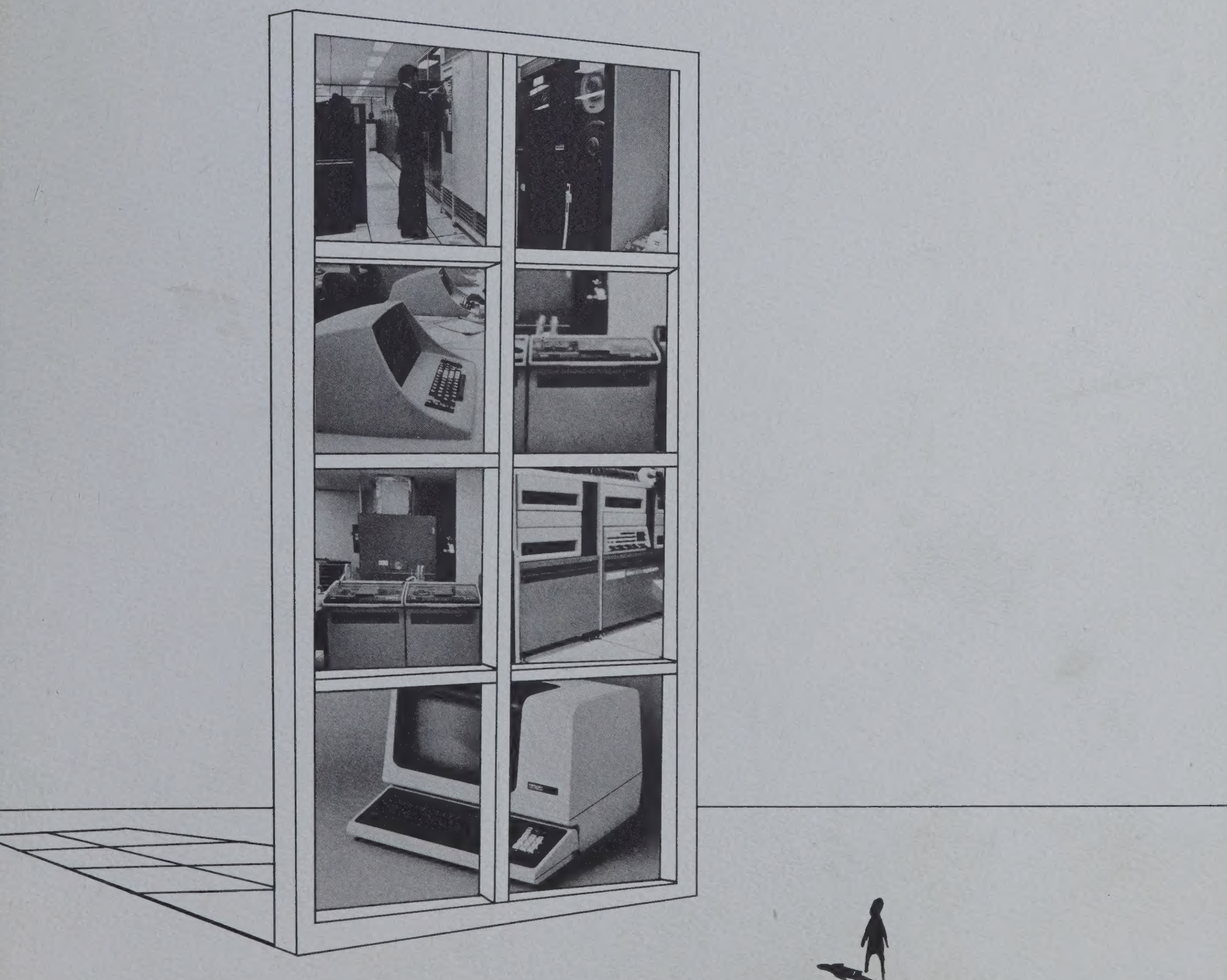
Martin Lynch

COMTECH

1980 Annual Report



Directors

James E. Houston
Chairman
Donald M. McPhail
President, Chief Executive Officer
J. Heath Halliday
Vice President
Noreen M. Stevens
Secretary
David Avrahami
John Cuthbert
Edward K. Loyst
Diane McPhail
Renato Zambonini

Inn on the Park

Annual General Meeting

The 1980 Annual and General Meeting of Shareholders of Comtech Group International Limited will be held in the Talbot Room in the Inn On The Park at 3:00 p.m. on November 27, 1980.

Comtech Group
International Limited
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Willowdale, Ont. M2J 2Z1
Area Code 416-492-1480

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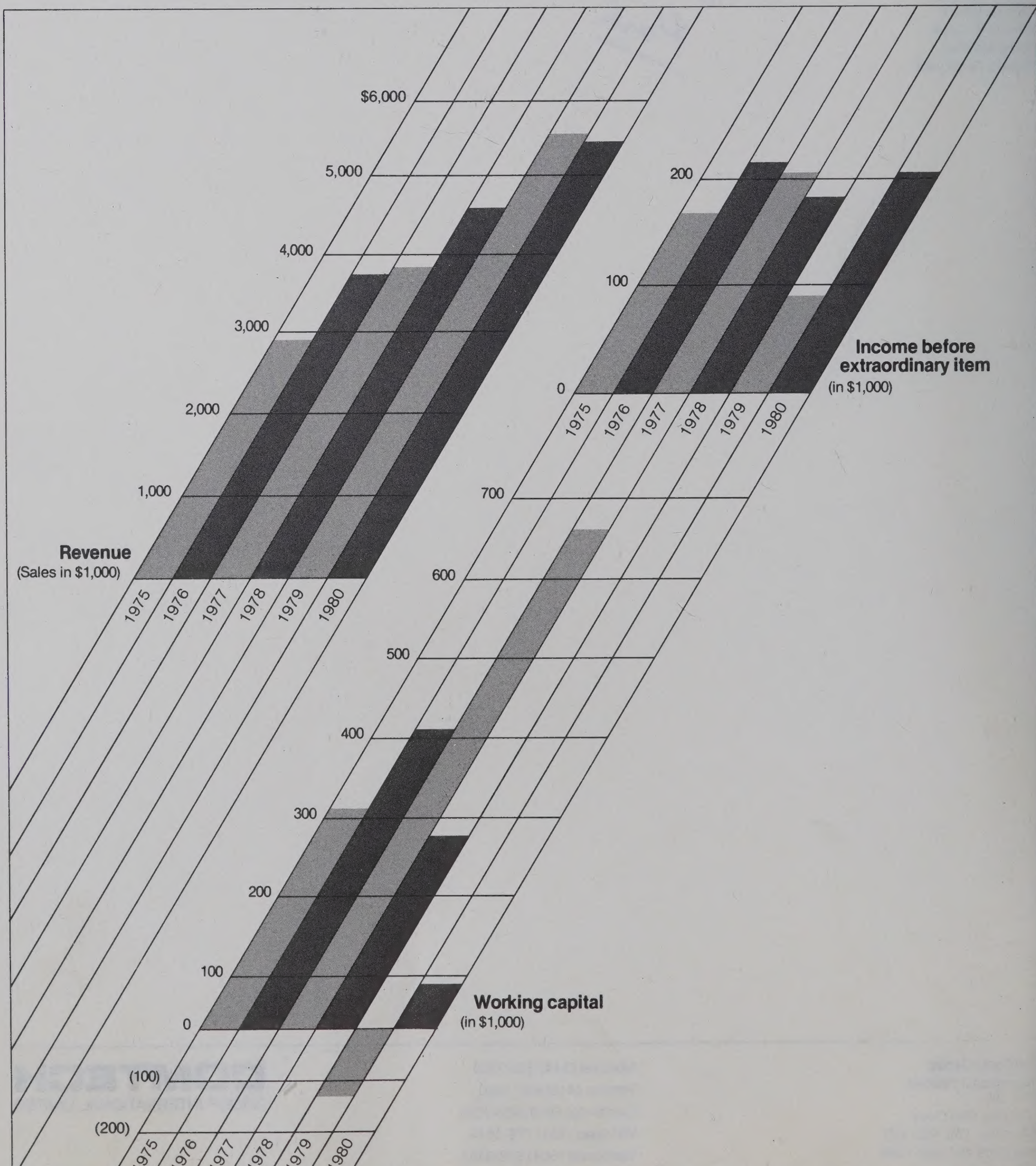
COMTECH
GROUP INTERNATIONAL LIMITED

	1980	1979	1978	1977	1976	1975
Revenue	5,665,417	5,701,794	4,364,916	3,735,449	3,726,085	2,913,715
Income before extraordinary item	209,738	92,274	190,255	201,583	216,319	171,676
Working capital	87,926	(122,685)	279,311	668,515	415,557	326,509



President's Report

Dear Shareholder:

I am pleased to report we completed our 1980 Fiscal Year with a net income of $209,738 compared to $92,274 in 1979. Our revenue for 1980 was $5,665,417 compared to $5,701,794 in 1979. The slight decline in revenue is associated with the discontinuance of custom work operating on our older equipment. This is also reflected in a reduction in our costs from $5,610,566 in fiscal 1979 to $5,417,179 in fiscal 1980.

The company's commitment to the development of new products is now well established. Our releases of the Invoicing Module and the complete Order Entry System occurred on schedule during the year. These products have been well accepted and we recorded substantial sales in the latter part of the year. With our development program reaching a more advanced level, our investment in new software declined from $769,433 during fiscal 1979 to $556,092 in fiscal 1980.

In the third Quarter of the year we installed an IBM 4341, to replace our IBM 370-138. This new equipment has both reduced our cost and substantially improved the performance in all areas of our production. In the coming year we expect to discontinue our development operation in Ireland and to relocate development in Toronto for all interactive systems. This change will further result in reduced costs in the latter part of fiscal 1981.

The company is well positioned with modern equipment and systems, and we are once again concentrating on marketing our product lines in Canada.

Yours very truly,

Assets

	1980	1979
Current:		
Cash	$ 69,761	$ 61,294
Accounts receivable	739,623	847,338
Loan receivable, non-interest bearing, due on demand	—	51,428
Income taxes recoverable	—	48,257
Inventories, at cost	122,304	113,617
Prepayments and sundry assets	128,635	167,430
Building for resale (Note 1)	159,862	—
	1,220,185	**1,289,364**
Investments (Note 2):	330,224	333,364
Package programmes (Note 3):	1,502,578	1,333,792
Fixed (Note 4):	223,019	454,682
Other assets and deferred charges	750	750
Goodwill and excess of cost of investments in subsidiaries over net assets acquired	795,047	800,830
	795,797	**801,580**
	$4,071,803	**$4,212,782**

On behalf of the Board:

(Director)

(Director)

See accompanying notes and Summary of Significant Accounting Policies.

Consolidated Balance Sheet — June 30, 1980

Liabilities

	1980	1979
Current:		
Bank indebtedness (Note 5)	$ 521,000	$ 569,000
Accounts payable and accrued liabilities	492,452	724,242
Deferred income taxes	18,807	18,807
Current maturities on long-term debt (Note 6)	100,000	100,000
	1,132,259	1,412,049
Long-term debt (Note 6):	200,000	300,000
Deferred income taxes	172,348	133,848
	1,504,607	**1,845,897**

Shareholders' Equity

		1980	1979
Capital Stock (Note 7):			
Authorized:			
13,690	5% First preference shares, $10 par value, cumulative, redeemable at $10.20 a share		
149,009	3% Second preference shares, $1 par value, non-cumulative, redeemable at par		
2,000,000	Common shares, $1 par value		
Issued:			
3,690	5% First Preference shares	36,900	43,870
47,009	3% Second Preference shares	47,009	55,107
885,713	Common shares	885,713	885,713
		969,622	**984,690**
Contributed surplus (Note 8)		110,505	101,000
Retained earnings		1,487,069	1,281,195
		2,567,196	2,366,885
		$4,071,803	**$4,212,782**

Consolidated Statement of Income and Retained Earnings

Year ended June 30, 1980

	1980	1979
Revenues	**$5,665,417**	**$5,701,794**
Costs and expenses	5,417,179	5,610,566
Income before taxes	248,238	91,228
Income taxes (Note 9):		
Deferred	38,500	(1,046)
Net income	**209,738**	**92,274**
Retained earnings at beginning of year	1,281,195	1,228,258
	1,490,933	1,320,532
Less, dividends paid	3,864	39,337
Retained earnings at end of year	**$1,487,069**	**$1,281,195**
Earnings per share	$ .23	$ .10
Average number of shares outstanding	885,713	885,713

See accompanying notes and Summary of Significant Accounting Policies.

Consolidated Statement of Changes in Financial Position

Year ended June 30, 1980

	1980	1979
Financial resources were provided by:		
Net income	$ 209,738	$ 92,274
Add (deduct) items not requiring a current outlay (receipt) of working capital:		
Depreciation of fixed assets	102,202	277,242
Amortization of package programmes	387,306	259,774
Amortization of excess of cost of investments	5,783	5,783
Gain on disposal of investment	(706)	—
Gain on disposal of fixed assets	(13,920)	—
Provision for non-current deferred taxes	38,500	(19,640)
Working capital provided from operations	728,903	615,433
Proceeds from disposal of investment	3,846	—
Reclassification of building for resale	159,862	—
	892,611	**615,433**
Financial resources were used for:		
Purchase of Comtech First and Second Preference Shares	5,563	375
Purchase of fixed assets	16,481	78,284
Purchase of investments	—	30,000
Package programme development costs	556,092	769,433
Retirement of long-term debt	100,000	100,000
Payment of dividends	3,864	39,337
	682,000	**1,017,429**
Increase (decrease) in working capital	210,611	(401,996)
Working capital (deficiency) at beginning of year	(122,685)	279,311
Working capital (deficiency) at end of year	$ 87,926	$ (122,685)

See accompanying notes and Summary of Significant Accounting Policies

AUDITORS' REPORT

To the Shareholders of
Comtech Group International Limited

We have examined the consolidated balance sheet of Comtech Group International Limited and its subsidiaries as at June 30, 1980 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at June 30, 1980 and the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

LIPTON, WISEMAN, GREENSPOON & ALTBAUM,
Chartered Accountants

September 23, 1980

Notes to Consolidated Financial Statements

Year ended June 30, 1980

1. **Building for resale:**
The company's building in Ireland has been listed for resale. It is carried in these financial statements as a current asset, valued at its initial cost less accumulated depreciation.

2. **Investments:**

	Cost
Selkirk Securities Limited	$300,000
Other	30,224
	$330,224

Comtech's investment in Selkirk consists of 300,000 4% cumulative non-voting class "A" special shares. These shares are redeemable at 115%. Selkirk is an investment and management company which owns 42.5% of Comtech's outstanding common shares. Selkirk is controlled by individuals comprising the senior management group of Comtech. Comtech accounts for this investment by the cost method.

3. **Package Programmes:**
The following is a summary of package programmes:

	1980	1979
Balance at beginning of year	$1,333,792	$ 824,133
Package programme development costs capitalized during the year	556,092	769,433
	1,889,884	1,593,566
Amortization of package programmes	387,306	259,774
Balance at end of year	**$1,502,578**	**$1,333,792**

4. **Fixed assets:**
Fixed assets are summarized as follows:

	1980			1979
	Cost	**Accumulated Depreciation**	**Net**	**Net**
Computer Equipment	$ 671,641	$ 613,252	$ 58,389	$ 87,367
Furniture and Office Equipment	241,585	141,359	100,226	121,121
Leasehold Improvements	214,662	150,258	64,404	80,881
Building	—	—	—	158,611
Vehicles	4,352	4,352	—	6,702
	$1,132,240	**$ 909,221**	**$ 223,019**	**$ 454,682**

Total depreciation during 1980 was $102,202 ($277,242 in 1979).

5. **Bank indebtedness:**
Bank indebtedness is secured by a general assignment of book debts.

6. Long-term debt:

Bank loan, evidenced by a registered debenture, bearing interest at 2% above the prime commercial lending rate repayable $25,000 quarterly	$ 300,000
Current maturities	100,000
	$ 200,000

The bank loan is secured by a first fixed charge on the company's computer equipment and a first floating charge over all other assets.

The annual payments required to meet aggregate principal retirements of the long-term indebtedness as at June 30, 1980 are as follows:

1981	$100,000
1982	100,000
1983	100,000
	$300,000

7. Share Capital:

a) The following is a summary of the changes in share capital during the year:

	First Preference Shares		*Second Preference Shares*	
	Authorized	*Issued*	*Authorized*	*Issued*
Number of shares, June 30, 1979	14,490	4,490	157,482	55,482
Cancellation of shares repurchased in prior fiscal years	(200)	(200)	(1,500)	(1,500)
Cancellation of shares repurchased during the current fiscal year	(600)	(600)	(6,973)	(6,973)
Number of shares, June 30, 1980	13,690	3,690	149,009	47,009

b) During the year, the company implemented an incentive stock option plan for officers and key employees, and granted options to purchase 44,000 common shares at $2.30 per share (being 15% below market value at the date of grant). These options become exercisable on a cumulative basis, 20% per year. None of the options for the 44,000 shares was exercised during the year; these options expire on December 31, 1984. Had the options that were exercisable during the year been exercised, there would not have been any effect on earnings per share.

8. Contributed surplus:

Contributed surplus has been increased by $9,505, representing the difference between the par value of preference shares cancelled during the year and the company's repurchase price of such shares.

9. Income taxes:

These financial statements show a low provision for income taxes, as a major portion of the income was earned by a foreign subsidiary whose taxes have been eliminated by Export Sales Relief provided under the Ireland incentive programmes.

10. Subsequent event:

The company has received approximately $35,000 of operating grants during the year ($300,000 in prior years) which have reduced expenses. In September, 1980 the company closed its research and development operations in Ireland, and as a result, became liable to repay approximately $184,000 of grants previously received from the Irish government. It has been arranged that the repayment will not be made until such time as the company disposes of its building in Ireland. The company expects the profit from the sale of the building to at least equal the grant repayments.

11. Contingent liabilities:

a) Two former officers have sued the company for damages for wrongful dismissal, claiming $100,000 in one case and $80,000 in the other. In the former case, management is of the opinion that the claim is unreasonable and unfounded. In the latter case, a court decision on September 19, 1980 found against the company and the former employee was awarded $38,000 plus interest and costs. This decision is being appealed and in the opinion of counsel, the company has a reasonable chance of success on appeal. Accordingly, no provision has been made in these financial statements for either case.

b) The company has been sued by Bene-Pack Insurance Agencies Limited for damages of $1,000,000 for failure to perform under a service agreement. The company has issued a counterclaim against Bene-Pack for negligence. In the opinion of management, the Bene-Pack claim is without foundation and has no chance of success.

proceeding along as rapidly as possible

12. Commitments:

The companies are committed to annual realty and equipment rentals of approximately the following amounts:

1981	$346,000
1982	262,000
1983	88,000
1984	57,000
1985-1986	26,000

13. Statutory Information:

The aggregate direct remuneration paid or payable by the companies to the Directors and Senior Officers of the company was $175,600 — eleven individuals ($216,690 in 1979 — twelve individuals).

Total interest expense for the year on debt initially incurred for a period in excess of one year was $57,750 ($59,900 in 1979).

14. Related party transaction:

During the year, the company paid management fees to Selkirk Securities Limited of $357,655 (1979 — nil).

Summary of Significant Accounting Policies

i) Principles of consolidation:
The consolidated financial statements include the accounts of the company and its subsidiary companies, all of which are wholly-owned except for Commercial Computer Services Inc. which is 99.5% owned.

ii) Inventories:
Inventories, which consist primarily of computer forms and supplies which are charged to customers, are valued at cost. As items become obsolete they are charged directly to operations.

iii) Fixed assets:
The company depreciates its fixed assets on a straight-line basis over their estimated useful lives.

iv) Package programmes:
It is the company's policy to capitalize the costs of package programme development and to amortize such costs on a straight-line basis over a five-year period, commencing in the six-month period following incurrence of such costs.

v) Goodwill and excess of cost of investments in subsidiaries over net assets acquired:
The excess of cost of investment in subsidiaries over equity in net assets acquired relating to those companies purchased on or before April 1, 1974 is not being amortized since, in the opinion of management, it has continuing value. As required by an accounting recommendation of the Canadian Institute of Chartered Accountants, goodwill and the excess cost of investments in subsidiaries over equity in net assets acquired relating to companies purchased after April 1, 1974 are being amortized; the company is using a straight-line basis for amortization over 40 years. The amount so amortized in 1980 is $5,783 ($5,783 in 1979).

vi) Income taxes:
The company follows the tax allocation method of accounting. Under this method timing differences between the amount of income reported for tax purposes and the amount of accounting income result in provisions for deferred income taxes.

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